

## MINUTES

### BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 500 Indianapolis, IN 46204

June 26, 2001

#### Trustees Present

Richard Doermer, Chair  
Nancy Turner, Vice Chair  
Jonathan Birge  
Teresa Ghilarducci  
Steven Miller

#### Others Present

Mike Gery, Executive Assistant to the Governor  
Diana Hamilton, Special Liaison to the Governor for Public Finance  
Stephanie Grieser, William M. Mercer Investment Consulting  
Micah Fannin, William M. Mercer Investment Consulting  
Richard Boggs, Burnley Associates  
Karen Franklin, National City Bank  
Faith Berning, National City Bank  
Brian Murphy, Portfolio Advisors  
Michael Galbreath, Portfolio Advisors  
Peter A. Keliuotis, Strategic Investment Solutions  
Curt N. Smith, Strategic Investment Solutions  
Don Hilt, PERF Retiree  
E. William Butler, PERF Executive Director  
Patricia Gerrick, PERF Chief Investment Officer  
Eric Swank, Ice Miller (Acting as PERF Legal Counsel)  
Diann Clift, PERF MIS Director  
Jeff Skinner, Assistant to PERF MIS Director  
Patrick Lane, PERF Director of Communications  
Kenneth Stoughton, PERF Human Resources Director  
Linda Stahl, Recording Secretary

#### ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of June 26, 2001 Meeting
- B. Minutes:
  - May 18, 2001 Board of Trustees Meeting

C. Reports, Summaries, Memorandums and/or Letters Concerning:

- ☐ Defined Contribution Plan
- ☐ Buildings Update
- ☐ Statement of Retired/Disabled Members
- ☐ Police & Fire Line-of-Duty Death Benefits
- ☐ Alternative Investment Consultant
- ☐ Quarterly Performance Analysis
- ☐ Quarterly Investment Compliance

A quorum being present, the meeting was called to order.

1. MINUTES APPROVAL

**MOTION** duly made and carried to approve the Minutes of the May 18, 2001 meeting of the Board of Trustees.

*Proposed by: Steven Miller*  
*Seconded by: Jonathan Birge*  
*Votes: 5 for, 0 against, 0 abstentions*

2. DISCLOSURES

Richard Doermer – Bank One stock ownership.

3. ADMINISTRATIVE

Leave Conversion Plan Resolution

The State legislature recently passed a bill that would allow State employees to convert unused accrued leave time into a monetary contribution to the deferred compensation plan. Because Board policy has previously been to keep PERF employee benefits similar to those of other State employees:

**MOTION** duly made and carried to adopt Resolution No. 01-01 providing that the employees of the Public Employees' Retirement Fund shall participate in the leave conversion plan administered by the deferred compensation committee pursuant to IC 5-10-1.1-1-7.5.

*Proposed by: Jonathan Birge*  
*Seconded by: Steven Miller*  
*Votes: 5 for, 0 against, 0 abstentions*

SIRIS Update

Diann Clift reported that SIRIS had been on-line for eleven weeks, and production levels are not what they should be. In that regard, Dr. Stephen Faherty with L.R.

Wechsler, Ltd. was brought on board to act as Operations Director. Dr. Faherty has considerable background in pension systems and will be assisting in merging SIRIS with the agency operations. An operations team, consisting of staff from across the agency, was put together, and any problem having to do with the agency's operations goes to them. They will be meeting weekly to ensure the process keeps moving forward. Also, a case management team meets weekly to handle individually those cases that get stuck and backlog the system because of their unusual nature. Statistical reports on retirement/refund processing production are being generated and given to the Executive Director on a monthly basis. Dr. Faherty is also assisting in determining the most beneficial use of staff resources. While slow, progress is being made. With Dr. Faherty's assistance, production numbers should increase over the next month or so.

#### 4. BENEFITS

The Benefits Administration Committee met on May 16 and recapped a discussion of the report generated by Cost Effectiveness Measurement. Additionally, the Executive Director reported that administrative staff had begun an employer communication effort and have met with approximately 18 of PERF's largest employers throughout the State.

#### 5. POLICE & FIRE

The 1977 Police & Fire Advisory Committee met in executive session on May 23 to review a line-of-duty death benefit application for Officer Douglas Adams, an Elkhart police officer killed in a traffic accident that occurred as he was assisting at the scene of a foot chase. After reviewing that application, the Advisory Committee unanimously recommended benefits be paid to the survivor of Officer Adams. Pursuant to the Board's resolution regarding the process for reviewing applications for line-of-duty death benefits:

**MOTION** duly made and carried to accept the 1977 Police & Fire Advisory Committee's recommendation and approve a line-of-duty death benefit in the amount of \$150,000 in the matter of Douglas Adams.

*Proposed by: Jonathan Birge*  
*Seconded by: Steven Miller*  
*Votes: 5 for, 0 against, 0 abstentions*

#### 6. ACTUARIAL

PERF's actuary, McCreedy & Keene, annually prepares an evaluation of the "K" and "M" formulas used to determine pension relief distributions. That evaluation is based upon the benefits reported as paid by cities and towns under the Indiana Municipal Police Officers' and Firefighters' Pension Plan. As a result of their

evaluation, McCready has recommended 2001 distributions in the following amounts:

- Distribution based on evaluation of “K” - \$65,012,000
- Distribution based on evaluation of “M” - \$16,320,510

Both distributions represent an increase over 2000.

**MOTION** duly made and carried to approve 2001 Pension Relief Fund “K” and “M” distributions in the amounts of \$65,012,000 and \$16,320,510 respectively.

*Proposed by: Steven Miller*

*Seconded by: Nancy Turner*

*Votes: 4 for, 0 against, 0 abstentions (Jonathan Birge absent for vote)*

## 7. INVESTMENTS

### Investment Committee Report

Steve Miller reported that the Investment Committee met on June 14 to discuss the matters of private equities, extension of the current custody contract, and an alternate equity investment strategy. Each of those issues follow as agenda items for Board discussion this date.

### Alternative Investment Consultant

Patricia Gerrick reported that an alternative investment consultant selection process was undertaken. She, in cooperation with Coopers Consulting, spoke with five different firms, using as the key criteria the following:

- The firm’s ability to provide core services --- planning, due diligence, and monitoring for partnerships, direct investments, co-investments, etc.
- The firm and staff’s experience in alternative asset consulting
- The firm’s resources to support Indiana PERF
- The firm’s involvement with prior private equity deals and access to current private equity deal flow
- The firm’s experience with large, public pension funds
- The firm’s experience introducing private equity programs to institutional clients
- The firm’s experience with direct investments and ETI

The results of those interviews were shared with the Investment Committee at their June 14 meeting, following which the Investment Committee recommended two firms for Board consideration. Those firms were Portfolio Advisors and Strategic Investment Solutions. Both firms were present for interview this date, and discussion began with Portfolio Advisors.

Representing Portfolio Advisors (PA) were Brian Murphy and Michael Galbreath. Mr. Murphy began by noting that Portfolio Advisors specializes in private equity investments. The firm is employee owned, and is comprised of 16 professionals. The four principals have over 75 years of combined relevant experience. Portfolio Advisors is a full service firm with three lines of business --- investment advisory, portfolio administration, and funds management. The firm was started in 1994 with investment advisory assets in the amount of \$450 Million. Today those assets total \$2 Billion. The firm then decided to put together for their clients an administrative reporting package to keep track of all private equities. It worked well and was then offered to firms other than their clients. IBM became their first portfolio-reporting client, and today PA has over \$30 Billion in administration assets in their reporting service. With respect to their funds management, they are a co-investment manager for IBM and do specialized funds management for firms such as MetLife.

Portfolio Advisors believes that the educational process in private equity is broken into three different components --- asset class education, program structuring, and ongoing education. Ongoing education would include:

- Periodic oral/written presentations to the Board on asset class and investments
- An introduction of the general partner of each recommended fund investment to staff
- Educational seminars, including the general partners' participation, for specialized sectors
- Annual portfolio review and planning meetings
- Portfolio monitoring and reporting presentation

In summary, Portfolio Advisors is a full-service private equity firm with a highly skilled senior team. They are long-term relationship oriented, and they have experience with State plans and in-State programs.

The interview process continued with Strategic Investment Solutions (SIS). Pete Keliuotis and Curt Smith were present representing SIS. Mr. Keliuotis began by noting that the firm was founded in 1994 by two individuals who had been senior people at Callan Associates. Their philosophy was to form a completely independent firm with no ties to the management community and to receive revenue only from plan sponsor clients. That philosophy has remained in tact. Additionally, the growth of the firm has been maintained by limiting their number of clients. Currently, the firm's clients total approximately 30. Since the firm's inception, only three individuals have left, and those three made career changes.

Education is a focus of SIS, and they always keep in mind how the education process fits with the total fund context. General education on alternatives would include:

- Risk and Return Characteristics

- Correlations
- The Wide Disparity of Returns

More specific education would include:

- Venture Capital
- Buyouts
- Debt-Related
- Real Estate: Core, Opportunistic, Debt-Related
- Absolute Return Strategies/Hedge Funds

Once a strategy has been implemented, SIS feels it is important to continue the education process over time as the program develops.

In summary, Strategic Investment Solutions is independent, and their interests are completely aligned with those of their clients. As a result of that they are able to maintain a very strong and clear client focus. They do accept fiduciary status, and their focus is on risk management. They feel it is very important to maintain that perspective, both from the individual asset class as well as more broadly within the fund.

Board discussion of the two firms ensued. Following discussion,

**MOTION** duly made and carried that the firm of Strategic Investment Solutions be retained as the Fund's alternative investment consultant.

*Proposed by: Steven Miller*  
*Seconded by: Jonathan Birge*  
*Votes: 5 for, 0 against, 0 abstentions*

### National City Contract

The custody contract with National City Bank (NCB) expires at the end of June, and PERF staff has been working with NCB to amend that contract. Various changes have been proposed. The first would extend the term of the contract to December 31, 2002. Additionally, the fee schedule would be changed for the SEI unitized accounting. Previously, it was \$400,000 per year. However, in discussions with NCB it was determined that SEI underbid the contract. Thus, that fee was raised to \$1.2 Million, which fell within the range of bids received from four other firms contacted by NCB. A third contract amendment would decrease the automated cash management sweep fee from 50 basis points to 18 basis points, which would result in an approximate savings of \$500,000 per year.

Following Board discussion,

**MOTION** duly made and carried to extend the National City Bank custody contract with amendments to include extension of the contract to December 31, 2002; an

increase in the unitized accounting fee from \$400,000 to \$1.2 Million per year; and a decrease in the automated cash management sweep fee from 50 basis points to 18 basis points.

*Proposed by:* Jonathan Birge  
*Seconded by:* Steven Miller  
*Votes:* 5 for, 0 against, 0 abstentions

### Domestic Equity Conceptual Review

Ms. Gerrick noted that prior to her engagement as PERF's Chief Investment Officer, a Request for Proposal for large cap domestic equity was issued. At their June 14 meeting, the Investment Committee was presented with a conceptual review of strategies to consider concerning the structure and establishment of PERF's equity allocation. Recommendations included:

- Utilizing the Russell 3000 Benchmark. Doing so would prevent the Fund from experiencing any tracking error because of a capitalization by its being either overweighted or underweighted to small cap.
- Eliminating indexation in the mid and small capped areas. The change with regard to the Russell 3000 would mean that the Fund would have a greater exposure to the mid/small cap area than it currently has.
- Doing the same with international by focusing the mandate on ACWI ex US as opposed to EAFE.
- Utilizing concentrated portfolios to implement these strategies, meaning managers who have a smaller number of securities in the portfolio would be hired in the large cap area. Over time, that would provide a higher volatility of return and a better chance of beating some of the large cap indexes. Risk would be mitigated by continuing to have a 75% index exposure on the domestic large cap side.
- Structuring some global portfolios. Looking at the capital markets, most of the institutional money management firms have started restructuring their staff into sector teams. Historically, these teams were structured by country specialty. Now teams are being structured by industry specialty. Utilizing a global structure would provide exposure to the analyst's best and highest convictions without regard to where it's geographically located. That's another strategy that has proven over time to add value.

Once the Investment Committee has had the opportunity to broaden this concept and provide more details, a plan will be presented to the Board for their consideration.

### Black Rock Financial Management

Black Rock Financial Management recently informed PERF that they are holding a security called 360 Communications, a part of Worldwide Fiber. Due to a liquidity

squeeze, the company missed its interest payment on the bond and now has 30 days to make payment. However, it does not appear they will be able to do so. Black Rock owns approximately \$40 Million of the issue. A major decrease in the bond's value was experienced in the first quarter of 2001. Ms. Gerrick has spoken with Black Rock to inquire why she was not made aware of the matter earlier. She noted that this is not a portfolio management issue, only informational.

Question was raised as to whether matters of this nature are something the Board cares to entertain now that they have a Chief Investment Officer on staff. Board consensus was that the Chief Investment Officer and the Investment Committee should resolve such issues, keeping the Board fully apprised.

#### Performance Analysis Report

Stephanie Grieser, William M. Mercer, continued with a first quarter performance report (report on file) and noted that during the quarter economic activity slowed considerably. The unemployment rate rose, and consumer spending grew at about a 3% annual rate. Responding to signs of recession, the Federal Reserve cut interest rates three times during the quarter. The CPI edged up during the quarter, and the Product Price Index increased 1.1%.

As in the last part of 2000, value outperformed growth, both in the small cap and in the large cap arena. International underperformed, so the fact that PERF went into international within the index and the enhanced index at the end of the first quarter as opposed to the beginning was actually a benefit to the Fund relative to their target allocation. Over the last 12 months, there has been a 60% discrepancy between Russell 2000 Growth and Russell 2000 Value, which is diametrically opposed to what occurred in 1999 when the growth area outperformed value by that much. Within the large cap arena there was a 40% discrepancy. So that could be seen somewhat in the small cap managers' results. However, if you look over a five-year period, despite this significant volatility, value and growth are pretty much equal.

Looking at fixed income, the Fund's investment managers who are focused on spread product, which is the non-Treasury aspect of the market, tended to outperform during the first quarter. The TIPS allocation did very well with a 4.8% return. Credit outperformed treasuries, as did asset backed securities, commercial mortgage backed securities, and mortgage backed securities.

With respect to performance, the total fund returned -4.8% during the first quarter. However, relative to all benchmarks, the Fund outperformed. Domestic equity contributed to first quarter performance relative to the index, coupled with the value bias within the small cap equity portfolio. Fixed income served as an anchor amidst the volatile equity markets, returning 3.1%.



## Investment Compliance Report

Richard Boggs, Burnley Associates, began his 1st quarter investment compliance report (report on file) by noting that all investment managers appeared to be following the investment styles for which they were hired. No significant violations of Guidelines were detected.

Lending income generated from securities lending continued strong, with revenues received totaling approximately \$1 Million during the first quarter. Trading and brokerage commissions averaged 2.2 cents per share. The S&P index trades were at 1 cent, the large cap enhanced at 3 cents, and the small cap managers traded at 4-5 cents, the latter reflecting the lower liquidity and greater difficulties of such trades.

Following Mr. Boggs' report, Teresa Ghilarducci noted that the area of proxy voting is something long neglected by the Board. ERISA interprets the proper handling of money on behalf of other people as requiring active voting of the shares because those shares are considered an asset to be managed. Funds typically go about this by hiring a proxy-voting firm, and Mr. Boggs has interviewed some firms who do proxy voting for public funds. Following some further discussion,

**MOTION** duly made and carried to authorize the Chief Investment Officer to work with Dick Boggs to explore the engagement of a proxy-voting firm. The CIO will then prepare a report for examination by the Investment Committee, who will in turn present their recommended candidate to the Board for consideration.

*Proposed by: Teresa Ghilarducci*

*Seconded by: Steven Miller*

*Votes: 4 for, 0 against, 0 abstentions (Jonathan Birge absent for vote)*

## 8. NEW BUSINESS

### SEC Lawsuit

Ms. Ghilarducci noted that there is now a movement among public funds to join together to file class action suits against companies who have lied to the SEC about their performance. Jim Osborn is exploring PERF's participation in such an action.

### Pensions & Investments Article

*Pensions and Investments* recently carried an article in which William M. Mercer was quoted as saying that the Ohio Teachers' Retirement Fund was the only fund that had a guarantee on their defined contribution assets. Ms. Ghilarducci noted that she is proud of the fact that PERF has had such a guarantee for some time. She would like to correct the record and will be sending the Trustees a copy of a

letter she has drafted. She asked that the Trustees e-mail her with any changes they might have, and she will then forward the letter.

### Strategic Planning

In a strategic planning session conducted on June 25, the Board directed that efforts be accelerated to hire both an Internal Auditor and Chief Financial Officer. The Trustees will be involved in the interview process for the Internal Auditor.

Also, recommendation was made that an audit be undertaken to look at PERF's current actuarial assumptions as well as its data integrity. Therefore,

**MOTION** duly made and carried to authorize the issuance of a Request for Proposal for actuarial audit services.

*Proposed by: Teresa Ghilarducci*

*Seconded by: Steven Miller*

*Votes: 4 for, 0 against, 0 abstentions (Jonathan Birge absent for vote)*

With the Board having previously given the Executive Director approval to fill the positions of Chief Financial Officer, Chief Benefits Officer, Fund Counsel, Internal Auditor, Investment Analyst, and Investment Assistant, a staffing development plan was distributed proposing the creation of another 20 positions. Following Board consideration:

**MOTION** duly made and carried to approve the staffing development plan as presented and to authorize the Executive Director to proceed with filling the following positions:

#### Benefits Division

Member Account Specialist (3)  
Active Member Counselor

#### Finance Division

Accountant III (2)  
Accountant IV  
Accountant V

#### Outreach Division

Outreach Services Manager  
Outreach Counselor (3)  
Publications Specialist

#### Call Center Division

Call Center Manager  
Call Center Specialist (4)

Internal Audit  
Assistant Internal Auditor (2)

*Proposed by:* Steven Miller  
*Seconded by:* Teresa Ghilarducci  
*Votes:* 4 for, 0 against, 0 abstentions (Jonathan Birge absent for vote)

The strategic planning session also included review of a draft proposed budget for the year ending June 30, 2002 (copy on file). Because the Fund has no authority to spend money after June 30, 2001 without the adoption of a budget:

**MOTION** duly made and carried to approve the July 1, 2001-June 30, 2002 draft budget with the provision that it will be replaced with a refined budget once completed.

*Proposed by:* Steven Miller  
*Seconded by:* Nancy Turner  
*Votes:* 4 for, 0 against, 0 abstentions (Jonathan Birge absent for vote)

9. NEXT MEETING

The next meeting of the Board, formerly scheduled for August 10, was rescheduled for August 13.